

COMPARATIVE ANALYSIS OF VENTURE CAPITALISTS INVESTMENT CRITERIA: A CASE FROM CHINA AND PAKISTAN

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ABSTRACT

This paper evaluates a method, intended by formal investors (venture capitalists) while making sound investment decisions and selecting those successful entrepreneurs in the emerging economies by identifying their basic investment criteria. The purpose is extended to compare the criteria used by venture capitalists of both countries along with the related risk profile faced by them. The online questionnaires were sent to the venture capitalists of both countries (selected from the official entities) which are followed up by the interview (face to face and electronic). It is found that venture capitalists of both countries act almost same while evaluating the individual criteria (entrepreneur's personality and experience) and corporate criteria (Product and Market characteristics). In terms of institutional or environmental criteria, Pakistani VCs are more demanding than Chinese VCs due to the lack of support from the financial and legal institutions. Further, Pakistani VCs attracted by the environmental level risk like country and geographical risk whereas Chinese VCs concentrates on the socio-culture and trade risk. While the VCs of both countries react in the same way to the venture and team level risk. Investment is a multi-stage process. The researchers are encouraged to enhance the investment criteria along with the stages of investment (deal-origination, deal-structuring and due-diligence).

Keywords: venture capitalist, investment criteria, entrepreneurs, emerging economies, institutional theory

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INTRODUCTION

It is believed that venture capital market (VCM) is the main source to expedite the technological and economic growth of a country (Maier & Walker, 1987). Economic and technological growth could be initiated and speeded up due to the high-growth potential businesses. On one hand high potential business typically needs high investments at the early stage of development unlike traditional ways of financing such as banks, on the other; there is a high level of asymmetry of information between these two future partners (Khatiashvili, 2009). Venture capitalists provide capital for the high growth projects at the early stage of development in the most advanced economies like United Kingdom, Canada and the United States. The accessibility of such high capital lay down a foundation for the emergence of various high growth firms in the developed economies, which confirms the importance of stable venture capital market in the west because it develops the entrepreneurial firms (Patricof, 1989). After the development of venture capital market in the US and Europe, it also spread out to Asia in the late 1980's, particularly to the developing countries. It is stated that venture capital marker (VCM) acts as a stepping stone for the economic growth (Aylward, 1998). Asian venture capital industry still up to some extent remain unexplored except Japan (Ray & Turpin, 1993) but the size of Asian venture capital industry is progressing leaps and bound i.e. \$10.5 billion increments occur in 2014 from \$6.3bn in 2013 ((BVCA), 2014). The US venture capital Industry and Asian industry should not be consider in the same position (Ahlstrom, 2000; Chow, 2000; Max Boisot, 1996) because in 2015 there were a record investment in the US venture capital industry i.e. \$48 billion which is 61% increase in dollars over prior year (Report, 2015).

Venture capital is the tool of the US which was then transferred to the rest of the world and venture capitalists belonging to different countries are trying to copy the pattern of venture capital industry of the US, however they face some institutional forces which compel them to act differently (Bruton, Fried, & Manigart, 2005). The venture capital culture in every country is shaped according to the institutional context of the country (Cetindamar, 2003). Venture capital is the most important instrument especially in emerging economies like Pakistan because it is trying to replace the traditional moods of production with the modern

methods i.e. from labor intensive to knowledge based and from relation based to market based, Although Venture capital culture is not too mature in Pakistan, because its origin is just dated back from the early 1990s but the Government of Pakistan along with the different institutions are adopting different policies for the improvement of venture capital industry. On one hand economic reforms initiated, foreign establishment was eased up, the flow of international money turned into easy and rapid way, privatization program were speeded up and foreign ownership of business was allowed by government since 1990, on the other hand, the Government of Pakistan also offered 7 years tax holiday in 2001 which were extended to 2014 for the encouragement of venture capital and ultimately stable financial market. In this period both venture capital fund financiers and fund management companies were stated tax exempt (Asian Development Bank). With the support of government, Security and Exchange Commission of Pakistan (SECP) issued an order called Statutory Regulatory (SRO) for the regulation of venture capital culture under the Venture Capital Companies and Venture Capital Funds Rules 2001.¹⁹ (Asian Development Bank).

Active venture capital market (VCM) is considered necessary for the structural conversion like from low income to middle-income economy and the existence of VCM can further expedite such conversion. Therefore, in order to understand the expansion and growth of these markets; this research will fill the research limitations in the area of formal investing i.e. elementary examination of entrepreneur's investment proposals. It is very difficult for the formal investors to take investment decision about the new venture or idea because at that stage the ventures have very poor or without any accounting data. That's why formal investors spend their valuable time on the selection of potential proposals and it is recorded that for the assistance and gaudiness of only one new firm they spend more than hundred hours in a year (Gorman & Sahlman, 1989). As it is shown that both the quantitative and qualitative data are necessary for the effective evaluation of new venture (Jelena & Santautè, 2011) and without such knowledge the venture capitalists cannot even think about the investment decision (Fried, 1994; Khan, 1987; MacMillan, Zeman, & Subba Narasimha, 1987; Muzyka, Birley & Leleux, 1996; Tyebjee & Bruno, 1984).

The main purpose of evaluation is to minimize the information asymmetry between the entrepreneur and formal investors (VC). Asymmetry

information is caused by the poor corporate governance and control system in Pakistan as compared to other Asian and Western countries. According to the institutional view, the investors of different countries will act in their own way due the environmental constraints and economic situations (Bruton et al., 2005) and culture settings (Li & Zahra, 2012) which they belong. Such differences in behavior while making investment decision by the venture capitalists around the world attracted many practitioners (Bruton & Ahlstrom, 2003; Bruton et al., 2005; Li, Vertinsky, & Li, 2014; Li & Zahra, 2012 ; Scheela, Isidro, Jittrapanun, & Trang, 2015; Zinecker, Marek, Bolf, & David, 2015). The second objective of the paper is to compare the Pakistani VC's behavior with the Chinese VCs.

In the process of local or cross-border investment, the organizations face different kinds of risk related to their local or international environment, natural, economical and geographical situation. The formal investors invest at the early stage of the companies which are passing through the valley of death because at that stage the risks and uncertainties are at peak level. According to the nature of our under consideration population, both the Pakistan and China are more open to these kinds of risks. The Chinese market is more competitive and Pakistani market faces some macro-level risks which are unavoidable. Based on the nature of both countries, the next purpose of this study to explore the risk profile of investment caused by the economic situation, technological, cultural and natural environment.

On one side, due to the economic and technological development, China turns to be the world second largest economy and still is grooming leaps and bound, on the other side, from the growth of China many economies have taken direct and indirect benefits recently. Pakistan is one of the major country which benefits from the development of China since 1963 (Aneja, 2006). China and Pakistan are the hot favorite countries for each other. The other reason for comparing China and Pakistan is the huge investment of China in Pakistan whereby, they have entered into a comprehensive plan of economic corridor called **China-Pakistan Economic Corridor (CPEC)**. Because of the strategic position of Pakistan, it will act as a stepping stone which will connect the South Asia and East Asia (Ahmad, 2015). For the last three decades in the south east region especially China, Pakistan and India have been on the forefront globally in terms of politics, trade and technology. According to Izurieta and Singh (2010) Chinese economy is growing by

double digits while Pakistan is an emerging economy with resources along double increment of workforce in the same period Freeman, (2007). This region is prospective intimidation to existing super economies like America, Canada and Europe (Siraj, 2011). By understanding the nature and behavior of Pakistan and Chinese VCs, the future mutual investment will take place in the effective environment and ultimately it will end up with high profit and stable venture capital market (VCM).

Theoretical Background

Theoretical background is much more interesting while evaluating venture capital because it covers the extremes of many challenges like uncertainty, asset intangibility and information asymmetry. At the beginning, limited theories were evaluated but as the development of other field like sociology anthropology etc., management became vast and boundary less. There are many theories in literature which evaluate the field of management like Agency theory, Stewardship theory, Social Judgment theory, Institutional theory (Bruton et al., 2005; Bruton, Manigart, & Fried, 2002; Cumming, 2005; Imamuddin, 2009; Li & Zahra, 2012 ; Scheela et al., 2015; Zinecker et al., 2015). All these theories are beneficial when the researchers were addressing issues from international perspective (Hoskisson, Eden, Lau, & Wright, 2000). In this study Institutional theory provides a theoretical background because it is the most comprehensive theory for international comparison (China and Pakistan).

Institutional Theory

According to Douglass North, institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction (North, 1990). The structure of the formal rules (law and constitutions), informal constraints (norms and contracts) and everyday lives which diminish the uncertainty are provided by such institutions. Many authors modified the definition provided by the North (1990) but basically, institutions are considered as long-lasting rules by which direct human exchanges. The Institutional theory can be expressed as that it divides the institutional forces of a country into three categories: normative, regulatory and cognitive (Bruton et al., 2005; McMullen, Bagby, & Palich, 2008; Scott, 1995a). In general management specifically in international entrepreneurial

setting Scott's (1995a) categorization gains a huge reputation (Busenitz, Gomez, & Spencer, 2000). The individuals (investors) will take their decisions (investment) according to the category which they belong. The effect of each facet of the theory on the individual are discussed as under:

Normative Institutions: What behavior and values are expected from an organization or individual, defined by normative force of the theory (Scott, 1995a). All the members of the organization are expected to act in the specific way as from the past i.e. the professional follow the designer to replicate what they had done without its economic consequences. Consistency is found in the action and beliefs among the United States and Chinese formal investors (VC) (Bruton, Dattani, Fung, Chow, & Ahlstrom, 1999; Fried & Hisrich, 1995).

Regulatory Institutions: The second force of the theory is the regulatory force which is embedded in the politics and law of a country which compel the individuals and organizations to act in a particular way (Scott, 1995a). The structure of regulatory institutions is different all over the world. These differences are based on the underlying viewpoint, lawful shield for investors, official implementation and the elementary scenery of the capital market system. Do as the Roman Do, is a good example which suits to U.S venture capitalists because when they were entering Indian market, they start following the rules and regulation of the Indian market (Wright, Lockett, & Pruthi, 2002) so the behavior of Venture capitalists is directly affected by the level of investor protection.

Cognitive Institutions: The fundamental ideas of social judgment theory and cognitive force are same. The society i.e. informal institutions shape the individuals thoughts like what should be the possible reaction to specific phenomena and what phenomena should not be considered (Scott, 1995b). These thoughts could be developed by association among the participant. Culture is the software of mind (Hofstede, 1991) and systems or official bodies are the product of most adopted culture (Hofstede, 2001). Culture is the reason for the cognitive force like different norms, values and social networks.

All the economic activities are significantly affected by the formal and informal institutions (North, 1990). Based on the above discussion

Institutional theory (normative, regulatory and cognitive) can explain the behavior (similarities and differences) of formal investors (VC) across the globe. Bruton and Ahlstrom (2003) and many other researchers stated that Chinese venture capitalists perform in a different way from the rest of the world (Bruton & Ahlstrom, 2003; Bruton et al., 2005; Hofstede, 2001; Li & Zahra, 2012). On the above theoretical foundation and literature support, we will find out the behavior of venture capitalists belongs to China and Pakistan. This rest of the study is structured as follows: this introductory segment is followed by the analysis of existing survey literature. Then the adopted methodologies are illustrated. Finally, the empirical results are presented in tables and diagrams and the paper ends up with the discussion of the implications and future recommendations.

LITERATURE REVIEW

Investment is the blood of the corporate world provided by the investors; Investor wants to make rational decisions, which ends with high profit. The question is “how to make rational decisions”; literature made out a path by which investors can judge the potential companies’ background and its management team. This part of the study shed light on prior literature and variables, evaluated by venture capitalists in the investment procedures. The existing research on VC’s behavior is classified into two dimensions: Processual research and criteria research. The Processual research focuses on the activities and events that bound the decision making process of venture capitalists (Tyebjee & Bruno, 1984; Wells, 1974), the criteria research studies the criteria while evaluating the investment proposal by the venture capitalists (Khan, 1987; MacMillan, 1985; Monika & Sharma, 2015; Wright et al., 2002; Zinecker et al., 2015). Some researcher used them together. Here the authors are trying to go one step further in the criterion research i.e. to identify the factors used by the venture capitalist while evaluating investment proposals at the early stage of the entrepreneurial venture. This is the hottest segment of financial markets for last three decades. There have been numerous studies conducted for the evaluation of special investment criterions implemented by formal investors (VC).

The game changers, Tyebjee and Bruno (1984) provided the groundwork to the researchers by analyzing the decision-making process of

venture capitalists followed by MacMillan. MacMillan (1985) divided the investment criteria into 27 items which are set under the six main headings these are Entrepreneur's personality, entrepreneur experience, product and market characteristics, market characteristics, financial characteristics and venture team. He ends up with one quotation i.e. "it's the jockey (entrepreneur) who can win the race rather than the horse (product), horse race (market) or odds (financial criteria)". It can be explained as that the investment decision of the venture capitalists can be affected more by the personality and experiences of the entrepreneurs rather than other characteristics like Product, market and financial considerations (MacMillan, 1985). Some other researchers also follow MacMillan and Tyebjee by studying the venture capital from different aspects till 2000 given as under (Ahlstrom, 2000; Aylward, 1998; Bruton et al., 1999; Fried, 1994; Muzyka, Birley, & Leleux, 1996; Muzyka, Birley, Leleux, 1996; Patricof, 1989; Guild & Bachher, 1996; Ray & Turpin, 1993; Shepherd, 1999; Fried, 1993). After 2000 the venture capital market speeded-up and spread all over the world.

Knight (2001) compared the US market, Canadian market, Europe market and Asia Pacific in term of investment criteria. He found that all the criteria rated normally but the personality and experiences of the entrepreneurs gained more privileges than other considerations of the firms like product, market and financial. A well-known name in the field of venture capital Garry Bruton provide another step by comparing the US with Europe and highlight the nature of venture capital in Asia. He used the institutional theory to study the behavior of venture capitalists and formulated that institutions can shape the behavior of venture capitalists (Bruton et al., 2002). Again Bruton used institutional theory as a base for the comparison of venture capital industry of China and West (Bruton & Ahlstrom, 2003).

Kakati (2003) explained the resource-based capabilities and competitive strategies of the formal investors along with the existing criteria identified by MacMillan. The result of the study showed that the success and breakdown of the company related to these elements. It is found that these factors can influence the success or failure of a new venture. Kakati reported that only the financial considerations are not the determinants of victory nevertheless the true entrepreneur along with the appropriate strategies and capabilities for the specific product will ultimately lead to the high return.

Silva (2004) examined the investment criterions and agreed upon the past criteria i.e. entrepreneur's personality and experiences (awareness, associates, dedications and idea of doing business) are the most wanted factors for the formal investors (VC) in the process of investment proposal evaluation. He also confirmed that financial considerations are not significantly important in the process of evaluation.

Mishra (2004) studied the Indian venture capital market through the forty-two criteria divided into six main categories and found that Indian venture capitalists (VCs) act differently from the others market including the US. He put forward that the basic factors in the process of investment proposal evaluation are the individual's characteristics i.e. personality and experience and followed by financial, product and marketing considerations of the firms. Pintado, Lema, and Auken (2007) focused on the VCM of Spain and formulated that all the factors belong to the owner are more important i.e. the honesty and Integrity were the top priorities and then works experience, management team, leadership skills and at last but not the least the knowledge of the sector. Some of the product characteristics are considered important but market-related issues rated higher than the product being high tech. But generally market issues are marked less than entrepreneur and product characteristics.

Zacharakis, McMullen, and Shepherd (2007) compared three major economies of the world i.e. the US, South Korea and China. They considered these economies as mature, emerging and traditional accordingly. The result shows that the venture capitalists in the rule-based economy based on the market information and South Korean and Chinese venture capitalists decisions are effect by human factors. The results also indicated the decisions of formal investors are partially affected by the institutions.

Franke, Gruber, Harhoff, and Henkel (2008) Formulated that, as the experience of the VC is changing, the decision making style is changing. He also made a tradeoff between the team members and showed that more experienced members take more concrete investment decisions. Imamuddin (2009) identified forty-one criterions of venture capitalists in Pakistani market and then compared it with US and Indian market through meta-analysis and concluded that entrepreneurs and management team are prominent criteria. He used agency theory as a foundation for comparison with US and India.

In Portugal, the same case is replicated and found that the individual criteria of the entrepreneur along with the administrative players are the most important standard for the evaluation of investment proposals (Nunes, 2014). Monika and Sharma (2015) provide a comprehensive review of the existing research which evaluates the criteria used by venture capitalists. They found that all VCs don't follow the same investment decision process while the allocation of funds to the new venture. Some provide more consideration to the entrepreneur's characteristics while some are considering the monetary and marketing characteristics of the new venture.

Risk Analysis

The Venture capital is a specialized form of high-risk investment activity. Whatever criteria are, the main purpose of proposal evaluation is to minimize risk at the every stage of investment (Driscoll, 1974; MacMillan, 1985). MacMillan (1985) Find out the six kinds of risk from the data through factor analysis i.e. investment risk, implementation risk, managerial risk, leadership risk, the risk of competition and exit. These risks are related to internal (Management and its leadership) and external domain (industry it operates in) of the company. Carter and Auker (1994) identified the same idea of risk that the risk profile related to the early stage of investment is different from other others stages of investment. Risk faced by the venture capitalists in different countries should be different according to the market structures, operating financial systems, the legal and economic environment of the country. These differences will be the highlight in the process of inter-country criteria comparisons (Hall & Hofer, 1993; Knight, 2001; Ravinder, 2000).

Research Issues

Past literature has provided some criteria used by the formal investors (venture capitalists) while making the investment in the new start-up, but yet a comprehensive study is required to evaluate both the Pakistani and Chinese venture capital market. This research tries to provide bases for the conversion of relation base industry to knowledge base one, investment procedures and economic development and to identify national differences; thus the research aimed at:

1. Exploring the existing key financial criteria used by the venture capitalists in both countries.
2. Testing other new criteria (resource based criteria and country risk etc.) as suggested by Ravinder.
3. Comparing the behavior of both Pakistani and Chinese venture capitalists.
4. Evaluating the associated risk faced by the venture capitalists.
5. Overcoming the sample size issue by obtaining a larger and more representative sample.

METHOD

Research Design

Different kinds of methodologies are used in the existing studies range from survey to interviews with verbal protocol analysis, multi-methods approach and so on. Based on the previous research of MacMillan (1985) and his followers, five main categories are studied, which include entrepreneur's personality, entrepreneur's experience, characteristics of the product or service, characteristics of the market, and financial characteristics. In addition, some new criteria are undertaken considering the nature of the venture capital industry, economic, political and cultural situation of Pakistan i.e. country and geographical risk as studied by Ravinder (2000). The criteria are classified into three main headings i.e. Individual criterions (entrepreneur's personality and entrepreneur's experience), Corporate and Industry criterions (product/services characteristics, financial characteristics and market characteristics) and Institutional or Environmental criterions (environmental conditions and country risk criterions). Four Point Likert-like scales are used to analyze the criteria: (1) irrelevant, (2) desirable, (3) important, and (4) essential used by MacMillan (1985) and his followers.

Relevant: Not a factor in the decision-making process.

Desirable: A factor which improves the likelihood of investment.

Important: A factor which must be present in order for an investment to take place, unless other factors specifically compensate for this factor's absence

Essential: A factor which must be present under any circumstances in order for an investment & to take place

Sample and Data Collection

Baseline Chinese study: This survey conducted on the base of samples drawn from the most famous cities (Beijing, Shanghai, Shenzhen and Hefei), which are considered investment hub and center of venture capital system of the country. These venture capitalist companies include domestic as well as foreign. Formal investors (Venture capitalists) are selected from the book “Venture capital development in china 2015”. According to the nature of the countries, a new questionnaire is designed which contain sixty criteria based on the literature. To avoid communication gap and to maintain the original logic of each question, the questionnaire is translated into appropriate language (Chinese). The online questionnaires were sent to the venture capitalist belongs to these venture capital companies and then authors follow up the venture capitalists through face to face interaction, telephone calls and most widely used social websites Weibo and mobile application WeChat. The response rate was higher than Pakistani market i.e. 70%

Baseline Pakistani study: According to the developing nature of Pakistani venture capital industry and limited number venture capitalists, the authors decide to study the behavior of all the investment team of the venture capital companies instead of the CEO, registered with Security and Exchange Commission of Pakistan (SECP) and some other VC companies involved in such activities. This paper is tried to overcome the sample size issue i.e. improved from six to fifty-seven with the response rate of 65% because the market comparatively quite matures now. The considered sample size from both countries is same because this study aimed to compare the behavior of formal investors (VC).

ANALYSIS OF THE RESULTS

Venture capitalists play in a market with limited and imperfect information, that's why they spend much of their time and great effort to collect enough information about the entrepreneurs and their projects (Chan, 1983; Sahlman, 1990). In this research, we have three major findings i.e. first we identified the existing investment criteria used by MacMillan (1985) which are modified with some new criteria from the literature because of the nature of the both countries. The similarities are given in Table 1 while

the differences in the behavior of formal investors are classified in Table 2 and Table 3 respectively. At last, we identified some risk factors used by Ravinder K (2000) according to the economic, investment, social and culture of Pakistan and its counterpart China in Table 04.

Resemblance and Discrepancies between China and Pakistan

Both countries China and Pakistan are emerging economies and belong to the same region of the Asia that's why the behavior of investors (venture capitalists) seems identical in some responses. These countries are the hot favorite for each other which make the basis for the evaluation of similarities. These similarities can be judged from the minimum differences in mean scores between (+0.10) and (-0.10) shown in Table 1. The positive signs of the value show the importance of the factor to the Pakistani VC while the minus sign point out that the facet in questions is essential to the Chinese formal investors (VC).

Table 1: Similarities between China and Pakistan

S.No	Evaluation Criteria	Pakistan Means	China Means	Means Diff
Individual criterions (Entrepreneur's Personality and experience)				
1	Desire for success	3.754	3.754	0
2	Venture stimulates an existing market	2.351	2.351	0
3	Ability to organize the management team	3.456	3.404	0.052
4	Ability to evaluate and react to risk well	3.754	3.561	0.193
5	Input sourcing capability	2.035	2.070	-0.035
6	Capable of sustained intense effort	3.719	3.737	-0.018
7	Articulate in discussing venture	2.877	2.947	-0.070
8	Thorough familiarity with target market	3.509	3.579	-0.070
9	Long term vision	3.579	3.649	-0.071
Corporate and Industry criterions (Product and services, Market and Financial Characteristics)				
10	Product developed to the point of a functioning prototype	2.632	2.544	0.088
11	Uniqueness of product	2.614	2.649	-0.035
12	Product owning the patent	2.175	2.228	-0.053
13	Life cycle of the product	2.193	2.263	-0.070
14	Demonstrated market acceptance of product	3.579	3.649	-0.070
15	Venture is in a market familiar to that of our venture capitalist firm	2.509	2.333	0.176
16	Low marketing and production costs	2.175	2.088	0.087
17	We will not participate in later rounds of investment	1.474	1.509	-0.036
18	Structure cost	2.719	2.842	-0.123
19	Low level of monitoring and administration costs	2.684	2.825	-0.141

In the individual criterion, the venture capitalists of both countries response exactly the same to some important variable on the four-point Likert scale like desire for success and venture stimulates an existing market (zero means difference). It shows that the thirst of the entrepreneur for success is essential to chase the financing opportunities while venture stimulates the existing market shows that whether the new venture going to stimulate the market by fulfilling the consumer needs or not. Ability to organize the management team (0.052) shows the managerial and leadership capabilities of the entrepreneurs which are most important while operating the organization. In most of the emerging economies, the risk is high and businesses can easily fail to achieve its goal that's why investors of both countries tend to evaluate the entrepreneur's personality in term of risk factors like, the ability of the entrepreneur to evaluate risk well and 0.193 difference is found in means. The other similarities are identified by means differences in factors as followed; sustainable intense effort of the entrepreneurs (-0.018), input sourcing capabilities (-0.035), articulate in discussing venture (-0.070), the entrepreneur's familiarity with the targeted market (-0.070), long term vision (-0.071), are the factors by which venture capitalists of both countries can evaluate the entrepreneur's hidden qualities.

In term of corporate and industry criterions investors have the similarities in the following responses; uniqueness of product (-0.035), product owning the patent (-0.053), life cycle of the product (-0.070), product developed to the point of a functioning prototype (0.088), they will not participate in the future round of investment (0.036), Low marketing and production costs (0.087).

In spite of these resemblances, the discrepancies are perhaps more fascinating. Two methods are used for the evaluation of differences between China and Pakistan i.e. the direct method of comparing means and Paired Samples T Test. First, we used **the direct method** of comparing means, by which we compare the means of both selected countries and discussed the criteria which scored above 0.50 in differences in means, accumulated in Table 2.

Pakistan study: Pakistani venture capitalists are given more weight age to the war and terror (3.807) because of the current status of the country i.e. terrorism is on peak which affects the overall economy of the country

but Chinese VCs marked war and terror as an irrelevant criteria with (2.368) means differences, which seems pretty good in the light of institutional theory. Geographical location (1.982) is another important criterion for Pakistani VCs because the nature of different area is not same all over the country. According to Elango, Fried, Hisrich, and Polonchek (1995) that every industry is different because of the geographical location and the size of the firms but for Chinese VCs the distance and geographical location is getting blur because of the easy communication and transportation. In China, the differences could be studied in term of human resources, local policies and the distance between them. Chinese VC marked the geographical location in questionnaire with average means (1.404) which goes opposite from the Bruton and Ahlstrom (2003) they provide evident that Chinese VC will invest in the firm which near to their home office.

A stable political environment leads to the stable economic environment, based on our study the Pakistani formal investors are interested in the stable political condition and marked Political risk as important criteria with high means difference (1.457) from china. Access to distribution channel (1.492) is considered important in Pakistani market because it could cause disturbance in the organizational environment, Ease of exit (1.07) the bankruptcy rate are comparatively high in Pakistan and it is important for venture capitalists to easily exit from the business with high profit but in China the success rate of the companies are very high because of the strong institutional environment and venture capitalists which can easily get rid of the business anytime.

The personality of the entrepreneur matters for Pakistani venture capitalists and they prefer the entrepreneur, whose personality is compatible with him (0.9998). Referred by a trustworthy source (0.982) means that entrepreneur is preferred by a trustworthy source (a well-known person or organization). The relationship-based approach can be defined as that VCs rely on their own personal and social circles inside and outside of the venture capital firm in investment decision process. Actually, they are trying to overcome the opportunistic behavior and agency problems. On the other hand, the Chinese venture capitalist marked these criteria as normal because they believe on the market intensive strategies which are based on the competitive resources, free from their personal and firms networks (Bygrave & Timmons, 1992). Ahlstrom and Bruton (2006) claimed that the rising

economies will shift to the market-based structure from relationship based structure over time and the Chinese market is providing evidence to them.

Chinese study: Chinese economy is more advanced and developed as compared to Pakistan, that's why the formal investors are less demanding and their intentions are slightly different towards the evaluation of investment proposals. Chinese venture capitalists give priorities to the demonstrated leadership ability in past (-0.737) because they believe in the market-based strategy for the evaluation of business proposals. The leadership qualities of the entrepreneur can be judged from the market history. High-tech product (-0.982) but the average mean is (2.105) which is not important because of the prompt development of the economy but at the same time, this criteria is almost irrelevant for Pakistani VCs which shows the lack of high technology business opportunities. Proprietary of the product (-0.772) are the most important criteria in China because the product should be protected from every kind of internal and external factor and the results are aligned with the MacMillan (1985). The early span of time for a startup is a very competitive stage so Chinese VCs gives more importance to factor barriers to entry of new products (-0.667). Chinese VCs demanding in term of subsequent investment with means differences (-0.614) as compare to their counterpart but the average mean (1.912) which is irrelevant and near to desirable. The results seem to be aligned with the literature that the VCs are interested in stage financing i.e. they don't invest the entire fund in the business in order to avoid potential losses from the bad apples (Gompers, 1995; Sahlman, 1990).

Table 2: Differences between China and Pakistan

S.No	Evaluation Criteria	Pakistan	China	Means Diff
		Means [SD]	Means [SD]	
1	War and terror	3.807 [.398]	1.439 [.501]	2.368
2	Geographical location	3.386 [.700]	1.404 [.495]	1.982
3	Political risk	3.632 [.555]	2.175 [.759]	1.457
4	Access to distribution channel	3.018 [.612]	1.526 [.538]	1.492
5	Ease of exit (by going public or acquisition, etc.)	3.930 [.257]	2.860 [.742]	1.07
6	Personality compatible with mine	2.930 [.677]	1.930 [.863]	0.9998
7	Referred by trustworthy source	3.614 [.491]	2.632 [.616]	0.982
8	Demonstrated leadership ability in past	2.474 [.709]	3.211 [.749]	-0.737
9	High-tech product	1.123 [.331]	2.105 [.880]	-0.982
10	Proprietary or otherwise protected product	2.316 [.805]	3.088 [.714]	-0.772
11	Raw material availability	3.018 [.719]	2.421 [.596]	0.597
12	Little threat of competition during the first three years (Barriers to entry of new products)	2.140 [.718]	2.807 [.742]	-0.667
13	Access to distribution channel	3.018 [.612]	1.526 [.538]	1.492
14	We will not be expected to make subsequent investment	1.298 [.461]	1.912 [.635]	-0.614

Notes: In Table 4, the difference in + (–) shows Pakistani VCs are more (less) demanding than China VCs

Paired Samples Test

Paired samples test is used for the comparison of two related variables; here we collected data from both countries (a group of VCs) for the same variables. The differences between variables can be judge from the P-value i.e. Sing (2-Tailed). If the P-value is less than 0.05, the two variables will be statistically significant. The results compiled in Table 3. The results of Paired samples T-test are parallel with the comparing means method.

Individual criterions (Entrepreneur's personality and experience):

In term of entrepreneur's personality and experience the factors, personality compatible with mine, the equity stake in the venture, demonstrated leadership ability in past and referred by trustworthy source are statistically significant i.e. the P-value of the variables are 0.00, integrity (0.004) and long term vision (0.044) which are less than 0.05. In our study the significance

level shows the importance of institutional theory. The rest of the factors, included in the entrepreneur's personality and experience, are statistically significant and insignificant shown in table 06.

Corporate and Industry Criterion: In the financial criteria the expected return equal to at least 10 times our investment within 5–10 years, Ease of exit (by going public or acquisition, etc.), We will not be expected to make subsequent investment, Sound business plan and Sensibility to economic cycle are significantly different among the Pakistani and Chinese VCs while the others are statistically insignificant (P0.05). In term of market characteristics, the Large market size, high market growth potential, little threat of competition during the first three years (barriers to entry of new products), venture creates a new market and access to distribution channel are the statistically significant (P0.05). While in term of product and services criteria global potential of the product, high-tech product, proprietary or otherwise protected product, ease of technical manpower procurement, raw material availability and competitive advantage are statistically insignificant (P0.05) and the rest are insignificant.

Institutional or environmental criteria: Based on the table most of the facets of institutional criteria are significant (P0.05) which means that these criteria are significantly different from each other. The negative signs in the table show the importance for Chinese VCs while the positive signs indicate the Pakistani VCs nature. The trade control risk is an insignificant (0.080) component in institutional criterion. The economic circumstances, institutional view, culture outlook and different experiences of the venture capitalists of both countries could lead to such differences in the process of project evaluation. These differences could be expressed in both positive and negative way i.e. it may cause more tension and conflict while having joint venture capital. On the other hand, by keen observation of these differences on VCs of both countries may produce sound investment projects. These differences are based on the economic circumstances, institutional view, culture outlook and different experiences of the venture capitalists; ultimately we can say that institutional theory supports these results.

Table 3: Paired Samples Test

Pair S.No	Evaluation Criteria	Paired Differences					t	df	Sing. (2.taile)	
		Mean	Std. Deviation	Std. Error Mean	95% confidence interval of the diff					
					Upper	Upper				
Individual criterions (Entrepreneur's Personality and Experience)										
1	Integrity	-.2281	.5675	.0752	-.3786	.3786	3.034	56	.004	
2	Long term vision	.0702	.2577	.0341	.0018	-.0018	-2.05	56	.044	
3	Capable of sustained intense effort	.0175	.4428	.0587	-.1000	.1000	-.299	56	.766	
4	Ability to evaluate and react to risk well	-.1404	.8115	.1075	-.3557	.3557	1.306	56	.197	
5	Personality compatible with mine	-1.0000	1.0690	.1416	-1.2837	1.2837	7.062	56	.000	
6	Articulate in discussing venture	.0702	1.0327	.1368	-.2038	.2038	-.513	56	.610	
7	Attends to detail	-.1579	.9962	.1320	-.4222	.4222	1.197	56	.237	
8	Insight and forecast ability	-.1228	.5997	.0794	-.2819	.2819	1.546	56	.128	
9	Commitment and enthusiasm	-.1754	.6846	.0907	-.3571	.3571	1.935	56	.058	
10	Equity stake in the venture	-.3509	.5172	.0685	-.4881	.4881	5.121	56	.000	
11	Managerial capability	-.1754	.5044	.0668	-.3093	.3093	2.626	56	.011	
12	Technical capability	.3860	.9775	.1295	.1266	-.1266	-2.981	56	.004	
13	Marketing capability	.3158	.5398	.0715	.1726	-.1726	-4.417	56	.000	
14	Input sourcing capability	.0351	.5658	.0749	-.1150	.1150	-.468	56	.641	
15	Demonstrated leadership ability in past	-.7368	1.0441	.1383	-1.0139	.4598	-5.328	56	.000	
16	Ability to organize the management team	.0526	.6387	.0846	-.1168	.2221	.622	56	.536	
17	Track record relevant to venture	-.2456	.8718	.1155	-.4769	-.0143	-2.127	56	.038	
18	Thorough familiarity with target market	-.0702	.5934	.0786	-.2276	.0873	-.893	56	.376	
19	Familiarity with entrepreneur's reputation	.1579	.5913	.0783	.0010	.3148	2.016	56	.049	
20	Referred by trustworthy source	.9825	.8127	.1076	.7668	1.1981	9.127	56	.000	
21	Educational background and careers	.1053	1.1601	.1537	-.2026	.4131	.685	56	.496	

Pair S.No	Evaluation Criteria	Paired Differences						t	df	Sing. (2.taille)
		Mean	Std. Deviation	Std. Error Mean	95% confidence interval of the diff					
					Upper	Upper				
Corporate and Industry criterions (Product and services, Market and Financial Characteristics)										
22	Uniqueness of product	-.0351	.5966	.0790	-.1934			-.444	56	.659
23	Global potential of the product	-.3509	.6941	.0919	-.5351			-3.816	56	.000
24	Product owning the patent	-.0526	.5801	.0768	-.2065			-.685	56	.496
25	High-tech product	-.9825	.9541	.1264	-1.2356			-7.774	56	.000
26	Life cycle of the product	-.0702	.9231		-.3151			-.574	56	.568
27	Demonstrated market acceptance of product	-.0702	.5298	.1223	-.2108			-1.000	56	.322
28	Proprietary or otherwise protected product	-.7719	1.035	.0702	-1.0467			-5.629	56	.000
29	Product developed to the point of a functioning prototype	.0877	.8511	.1371	-.1381			.778	56	.440
30	Ease of technical manpower procurement	.3509	.9727	.1127	.0928			2.723	56	.009
31	Raw material availability	.5965	.9794	.1288	.3366			4.598	56	.000
33	Competitive advantage	.2807	.5263	.1297	.1411			4.027	56	.000
33	Demand for the product	-.2456	.9118	.0697	-.4876	-.0037		-2.034	56	.047
34	Large market size	-.4737	.8885	.1177	-.7094	-.2379		-4.025	56	.000
35	High market growth potential	-.4561	.7576	.1003	-.6572	-.2551		-4.546	56	.000
36	Barriers to entry of new products	-.6667	.9512	.1260	-.9191	-.4143		-5.292	56	.000
37	Venture is in a market familiar to that of our venture capitalist firm	.1754	.5708	.0756	.0240	.3269		2.320	56	.024
38	Venture creates a new market	.7719	1.210	.1603	.4508	1.0931		4.815	56	.000
39	Venture stimulates an existing market	.0000	.7559	.1001	-.2006	.2006		.000	56	1.000
40	Access to distribution channel	1.4912	.8477	.1123	1.2663	1.7162		13.281	56	.000
41	Expected return equal to at least 10 times our investment within 5–10 years	-.7719	1.2958	.1716	-1.1158	-.4281		-4.497	56	.000

Pair S.No	Evaluation Criteria	Paired Differences							t	df	Sing. (2.taile)
		Mean	Std. Deviation	Std. Error	95% confidence interval of the diff		Upper				
					Mean	Upper					
42	Ease of exit (by going public or acquisition, etc.)	1.0702	.8207	.1087	.8524	1.2879	9.845	56	.000		
43	Capacity to obtain complementary financing	.1250	.6049	.0808	-.0370	.2870	1.546	55	.128		
44	We will not be expected to make subsequent investment	-.6140	.7963	.1055	-.8253	-.4027	-5.822	56	.000		
45	We will not participate in later rounds of investment (requires our participation in initial round)	-.0351	.7551	.1000	-.2354	.1653	-.351	56	.727		
46	Sound business plan	.5088	.7820	.1036	.3013	.7163	4.912	56	.000		
47	Sensibility to economic cycle	.3860	.8814	.1168	.1521	.6198	3.306	56	.002		
48	Structure Cost	-.1228	.8253	.1093	-.3418	.0962	-1.123	56	.266		
49	Low marketing and production costs	.0877	.8298	.1099	-.1325	.3079	.798	56	.428		
50	Low level of monitoring and administration costs	-.1404	.8544	.1132	-.3670	.0863	-1.240	56	.220		
Institutional or Environmental criterions											
51	Government tax benefits	-.2807	1.0480	.1388	-.5588	-.0026	-2.022	56	.048		
52	Government regulations	.1930	.4795	.0635	.0657	.3202	3.038	56	.004		
53	Geographical location	1.9825	1.0937	.1449	1.6923	2.2726	13.685	56	.000		
54	Political risk	1.4561	1.0702	.1418	1.1722	1.7401	10.272	56	.000		
55	Exchange - Exchange	.2632	.6950	.0921	.0787	.4476	2.859	56	.006		
56	Trade Control Risk	-.2456	1.0399	.1377	-.5215	.0303	-1.783	56	.080		
57	Socio-cultural risk	-.5789	.8226	.1090	-.7972	-.3607	-5.314	56	.000		
58	War and terror	2.3684	.6162	.0816	2.2049	2.5319	29.019	56	.000		
59	Natural Risk	.8596	.8750	.1159	.6275	1.0918	7.417	56	.000		

Risk Management

Carter and Auken (1994) tried to identify that the risk profile of early stage investments is different from that of the late stage investments but they didn't find any significant differences. Both kinds of investments have the same kind of risk profile i.e. internal and external risk factors. While in the process of evaluation investment criteria all kinds of risks should be studied, identified by the Driscoll (1974), MacMillan (1985), Ray and Turpin (1993) and Ravinder (2000). MacMillan (1985) divided these risks into six categories i.e. investment risk, bailout risk, implementation risk, competition risk, leadership and management risk. Leadership and management risk are the internal risks to the firm and others are outside of the domain of the firm i.e. external risk (the industry, market and competitors).

Based on the market structure and economic conditions, the formal investors of China and Pakistan would evaluate these risk criteria differently. MacMillan (1985) used comprehensive and complex statistical technique (factor analysis) to identify these kinds of risk. This analysis was used to determine the relation among a large bunch of variables. As we discussed that venture capital market (VCM) in Pakistan is very limited which leads to the limited sample size. Factor analysis is an inappropriate for this study because of the assumptions of factor analysis (KMO Bartlett's value must be greater than 0.5) and the circumstances of the population. The authors decided to follow the Ray (1993) while analyzing these risks with the response rate (essential or important) of the formal investors which give insight into some new kinds of risks. The behavior of formal investors in both countries China and Pakistan, are slightly different from each other in some aspects of risk profile.

Here the risk profile of both countries categories in three layers special levels i.e. the environmental, the venture and the entrepreneur level as shown in the Figure 1. The mean values of risk related factors are given in Table 4.

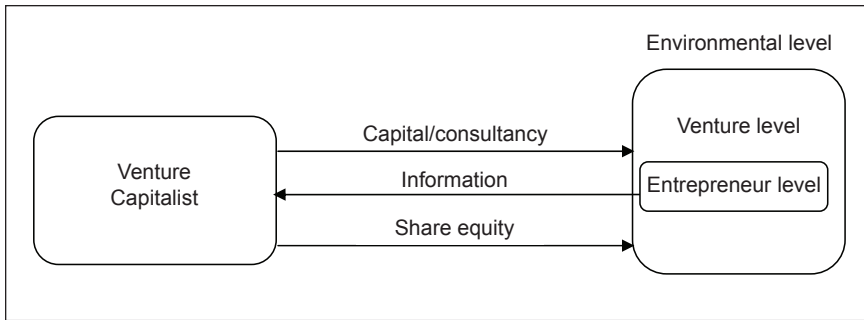


Figure 1: Risk Management

The Environmental Level

This level contains the industry trends, economic, political, cultural, geographical and natural conditions of the country and these factors can affect the relation among the venture capitalists, entrepreneurs and their associated venture. By the keen observation of the responses, we can evaluate the environmental risk level in the following risk factors;

Country risk: Probable fluctuations in the business atmosphere which affect the operation and profit of companies in a negative way are called country risk. Pakistani venture capital market (VCM) is more open to these kinds of risks instead of China because most of the on-ground opportunities have been blemished due to security threats and unstable political environment that have stained the country for years. The ultimate responses of Pakistani VCs are different from their counterpart and they recognized these kinds of risk through war and terror (3.807), Political risk (3.632) and Geographical location (3.386). As literature shows that Chinese venture capital market (VCM) is stable and progressing day by day as compared to Pakistan. The macroeconomic environment is also important for Chinese venture capitalists and they also concentrate on such kinds of risk but from different perspectives i.e. Trade control risk (3.018) and Socio-cultural risk (3.053).

The Venture Level

The venture or business model level shows the situation of the company i.e. is it possible for the company to extract the expected returns

on investment supplied by the formal investors (VCs). The relation between the VCs and the venture is shown by the flow of capital and consultancy from the VC to the firm and in returns their share equity. Such relation could be affected by the different kinds of risk, as under;

Investment Risk or Risk of loss: Deviation from the expected proportion of return is called investment risk and it could be studied from the soundtrack records of the entrepreneurs, high-growth capacity in the markets, these both are recorded important by the venture capitalists of China and Pakistan. The differences found in the behavior of the investors in the response toward the 10 times payback in 5-10. Chinese VCs consider it important while its counterpart responds normally.

Implementation risk or Market uncertainty: Venture capitalists distillate on the two aspects of entrepreneur's business proposal i.e. the nature of the business plan and implementation of business plan. From the implementation of the business plan one can have a clear idea of what entrepreneurs are doing, what are the functioning prototype, and the demonstrated market acceptance. Demonstrated market acceptance is the most significant aspect for the venture capitalists, instead of the market size and the market growth rate. The rate of failure increases as the demonstrated market acceptance is decreases and that's why VCs of both countries responds it essential.

The Team Level

This level shows the execution ability of the entrepreneurs i.e. to transform the plotted plans into the reality. The entrepreneurs and their team should provide the information about their abilities and strengths to the venture capitalists. Many risk factors are related to the entrepreneurs and their team which could be judged from different perspectives as shown below;

Management Risk or Moral hazard Risk: The venture capitalists (VCs) of both countries curves almost same to this kind of risk. Management risk or moral hazard is recognized from the mean value of integrity and sustainable intense efforts. VCs of both countries considered these criteria essential which show the importance of management or moral hazard risk.

VCs fascinated by the entrepreneurs who work for the objectives of the firm instead of their own i.e. to avoid agency problems.

Leadership risk: Leadership is a multifarious process of attaining goals through the balance of internal and external culture and environment of the organization. In this study, the venture capitalists solely focus on the demonstrated leadership of the entrepreneurs. The Chinese VCs respond it important (3.211) while Pakistani VCs respond it normally (2.5).

The differences from the literature of this study could not draw a clear line in term of bailout risk and competitive risk because the venture capitalists of both countries marked normally the facets of these kinds of risk i.e. Proprietary product little, Competition threat and could the product encourage the present market.

Table 4: Risk criteria between China and Pakistan

S.No	Related Risk Criteria	Pakistan		China	
		Means [SD]	Variance	Means [SD]	Variance
1	Government tax benefits	1.614[.6197]	.384	1.895[.7242]	.524
2	Government regulations	2.632[.5865]	.344	2.632[.5865]	.344
3	Geographical location	3.386[.7009]	.491	1.404[.4950]	.245
4	Political risk	3.632[.5552]	.308	2.175[.7588]	.576
5	Foreign exchange risk	2.825[.5044]	.254	2.561[.5006]	.251
6	Trade control risk	2.772[.4233]	.179	3.018[.6679]	.446
7	Socio-cultural risk	2.474[.5037]	.254	3.053[.6660]	.444
8	War and terror	3.807[.3981]	.159	1.439[.5006]	.251
9	Natural Risk	2.404[.5625]	.316	1.544[.5692]	.324

DISCUSSION

High growth potential business needs high investment which ultimately leads to high technological and economic growth. Venture capitalists provide such huge investment to the firms at that early stage, unlike old-fashioned financing. Entrepreneurs consult the VCs with the potential investment proposal. The venture capitalists evaluate the investment proposal from different perspectives. This study focused on the factors (Criteria) used by the formal investors/venture capitalists from China and Pakistan, in the process of investment proposal evaluation. Our study is different from the

rest in terms of comparison because past researchers conduct only meta-analysis but we collect the real data from both countries and then compared them in the light of institutional theory. The results of our empirical study as follows:

First and foremost, we find out the investment criterions followed by formal investors (venture capitalists) in China and Pakistan. Criterions are divided into three broad categories i.e. individual criterions (entrepreneur's personality, entrepreneur's experiences), corporate and industry criterions (product and services characteristic, market characteristics and financial characteristics) and institutional and environmental criterions (environment conditions and country risk).

Secondly, we compare the results of both countries which provide some similarities and differences in the actions or attitude of venture capitalists. On one hand, the economic, institutional and culture profile of the countries support the results of the study. On the other hand, the institutional theory provides strong support to the results. Most similarities are found in human capital or individuals capital (entrepreneur's personality and experiences) and corporate and industry level. Surprisingly, the results of institutional or environmental criterion are so much different from each other because of the natural and environmental sketch of the countries.

Thirdly, we analyzed the risk factors on the basis of investor's comebacks i.e. essential and important. We identified the three main kinds of risks i.e. the environmental level risk, the venture level risk and the team level risk. The behavior of the investors towards the leadership and country risk is different. Chinese tends to leadership while Pakistani formal investors emphasis on country risk because the business environment has been tarnished by the securities hazard and unstable political system. Chinese formal investors also focus on the country risk but in term of trade control risk and socio-cultural risk. Management risk, investment risk and implementation risks on the top priorities of the formal investors in both countries.

The theoretical implications of our research conclude in three coats. *First*, from the communication with formal investors, we find out the investment criterion, which are modified and broader up to sixty criteria

under the light of literature. *Second*, our findings enrich with the new ideas within the subject of venture capital comparison. Prior studies found these criteria by collecting data only from the base country and then compared the result with other countries through meta-analysis, while we interconnect with formal investors of both countries and then compare the results to strengthen the Institutional theory. Last but not least, we identified the risk factors from the profound study of economic situation, cultural and environmental condition of both countries.

Our research has significant enlightenment in the process of evaluating investment proposals. *First* of all, it is useful for indigenous entrepreneurs to have a rational understanding of the behavior of formal investors and then make effective business proposals. Entrepreneurs spent most of their time to meet potential investors and the business plan or proposal is the only one way to communicate with them so they often try to make attractive and well-supported documents for those potential investors. Our research will help them by providing enough information about the investor's intentions toward investment proposals. *Secondly*, our study has important connotation for extraneous entrepreneurs and investors who are attracted by the cross-border businesses and investments, this study follows the institutional theory which states that the behavior of the entrepreneurs and investors will change according to the normative, regulatory and cognitive institutions of the country. Both China and Pakistan are the hot favorite for each other in term of investments so this study can provide information regarding the nature of the targeted country. The last but not the least, this study has useful implications for research institutions to conduct more comprehensive cross-border studies in the field of venture capital in term of economical, technological, cultural and natural aspects of both countries.

The limitations of our research are summarized as follows; *firstly*, the criterion evaluated in this study could be modified from different approaches which fully represent the nature of formal investors. *Secondly*, this study overcomes the sample size issue but it is still low as compared to the selected number of criteria and to represent both countries especially for China. The future research requires enlarging the existing sample sizes by which researcher may apply some other statistical analysis like factor analysis and such analysis which will provide a stronger basis for the results. *Thirdly*, Decision making is a complex and multi-stage process which requires

in-depth analysis from different perspective like deal origination, deal structuring and due-diligence which will enhance the worth of the study. *Lastly*, our study concentrates on the nature of Venture capitalists belonging to private equity group, to enhance the effectiveness of the study, the future research could study angel investors of both countries.

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